NOTES

WASHINGTON NOTES

OUTCOME OF THE THIRD LIBERTY LOAN

Final figures for the Third Liberty Loan, showing total subscriptions of $4,170,019,650, or an oversubscription of about 39 per cent, the total number of subscribers being not far from 17,000,000, represent an outcome that far exceeds in success anything that had been expected either by Treasury authorities or by observers of the banking condition of the country. The three successive Liberty Loans afford an interesting progression in matters of public finance. The first, offered at 3 per cent and with very large provisions of exemption from taxation, appears to have been subscribed almost entirely by men of large income, and the subsequent transfers of bonds have tended still more to concentrate the securities of the first loan in the hands of the wealthier class in the community; the second, placed at 4 per cent, was taken by about 9,500,000 subscribers as against 4,500,000 for the first loan, and the facts would indicate that it was absorbed to no inconsiderable extent by people of moderate resources; the third loan, taken by 17,000,000 persons, seems to be not only far more widely distributed than either of its predecessors but also far more evenly absorbed—that is to say, it has been taken in blocks of far more nearly uniform and average size than was true of either the first or second loan.

There are several conditions which have contributed to this progressive change in the distribution of the several loans. In the first place, as the war has advanced and an understanding of it has become more general there has been developed a far better understanding not only of the objects of the war but also of the financial problems and responsibilities involved in it, and now, for the first time, the interest of all classes in the community is becoming thoroughly aroused. Secondly, the changes in the conditions and terms upon which the loans have been issued have decidedly altered the character of their appeal. Finally, a most important feature has been found in the change in methods of taxation which has occurred during the time the loans have been in progress. The present income and excess-profits taxes have necessarily absorbed a

very large share of the current income of persons with large means and investors of this class have been markedly absent during the period when the Third Liberty Loan was being placed. Perhaps the most satisfactory element in the whole situation, however, is the fact—which now appears, from informal reports, to be such—that only a comparatively limited degree of reliance upon banking assistance has been necessary.

So far as the flotation of the loan has thus far gone it is apparent that the smaller purchasers have preferred to draw upon their accumulated funds or savings rather than to rely very largely upon the assistance of their banks. Larger subscribers have, as usual, to some extent anticipated their future income for the purpose of increasing their subscriptions to bonds, but, partly due to the relatively less important share of the loan taken by these larger subscribers, such assistance has been kept to very moderate proportions. It is never possible to state in exact terms the effect of a great public loan upon the banking position until time has elapsed sufficient to permit the permanent absorption of the bonds. Some careful observers believe that the next few weeks will see a certain increase in applications for rediscounts at Federal Reserve banks, protected by government obligations, the proceeds to be used in enabling the member banks to provide for renewals or new loans necessitated by the wants of those who are engaged in the process of absorbing and carrying the government securities. This may or may not prove to be the case, but even should it be so, there is no reason at this time to believe that the demand thus exerted will be more than temporary or will exceed very moderate proportions. Unless the government's requirements should be increased much beyond the average figures of the past year the experience of the Third Liberty Loan would furnish good reason for believing that they could be met by the present methods of financing.

CALL FOR NEW TAXATION

The indicated prospect, however, is that the demands to be met during the coming year will be much larger than had been indicated during the past year. Secretary Baker's estimate that expenditures in connection with the placing of an adequate army in France may possibly run to $15,000,000,000 has largely changed the basis of computation. Assuming that some $3,000,000,000 or $4,000,000,000 are obtained from income and excess-profits taxes, and that Liberty Loans can be successfully floated in about the same proportion as during the past year (a total of $10,000,000,000 in round numbers), there would still remain a requirement of several billions to fill the gap due to the new estimates of

army and navy costs. As a result of this situation government officers are now looking to the possibilities of new taxation, but they find that excess-profits taxes have already been carried to the point of apparent maximum yield and that the taxes on the higher incomes can probably be increased but little from the standpoint of productiveness.

The higher middle-class incomes are already bearing a rather heavy burden, so that the natural conclusion has been tentatively in favor of increasing the rates of the normal tax and providing for a system of consumption taxes. Proposals to this effect are now before Congress, with the recommendation that they shall be acted upon at the current session. The question raised by such a suggestion is whether or not the extension of the system of taxation along the lines suggested will or will not actually result in bringing in a larger gross income to the government, or whether it will not result in somewhat reducing the yield. The experience of the Third Liberty Loan shows that the higher income recipients have in part discontinued their subscriptions because of the increasing burden of income and excess-profits taxes.

If the tax burden should now be carried on down into the lower ranges of income it would probably have the same effect upon bond subscribers in these income levels as has already been exerted in the higher ones. The truth is that the government is now taking, either through loans or taxation, practically the whole of the savings margin of the community, and that the only way of increasing the amount it can get is through increasing either the total product of industry or the amount of it that is saved. Some increases in productiveness may be possible, although they must of course contend with the steady drain of labor into the fighting forces. Savings can undoubtedly be largely increased and must be if greater outlay on war is to be provided for. The raising of funds through any other means would imply nothing more than inflation of credit and the raising of prices, processes neither of which would be of the slightest advantage to the government and would be of immense disadvantage and injury to the public. The problem of government financing is thus not, as was erroneously supposed by a large number of economists at the beginning of war, a choice between loans and taxation as methods of getting government revenue, but a problem of encouraging the development of a surplus of wealth that can be made available by either means for government purposes. There is grave danger that, in the new taxation plans, this point might be lost sight of and a mere theoretical preference for taxation be allowed to counterbalance a need for larger income.

THE "INFLATION" SITUATION

The continued high prices and the apparent tendency of prices to advance to still higher levels have brought about a more active discussion of the theory of prices and conditions tending to raise them than has existed at any time within perhaps twenty-five years. Foremost in this discussion is the question whether "inflation" is or is not the result of the operation of the Federal Reserve System, and if so in precisely what way. Much of the current discussion has apparently been based upon vague or indefinite ideas of the meaning of "inflation," but there is now considerable evidence that a more general consensus of opinion and agreement as to definitions is in sight.

"Inflation," in the sense in which the term is now being used by the more careful writers on the subject, is taken to signify the increase of bank credits not represented by any immediate addition to current wealth. Thus, for example, if the government borrows by an issue of bonds, such bonds being taken by the banks and payment for them made in the form of bank credit which is at once transferred to individuals who have furnished labor or supplies, it is evident that there has been a net addition to the purchasing power of the community not represented by any corresponding addition to wealth, whether of a salable or available form or otherwise. Here there is an "inflation" or exaggeration of, or addition to, the actual purchasing power of the community as compared or contrasted with the amount of goods in existence. From this point of view the measure of "inflation" is afforded by the total new holdings of bonds in banks which have become the basis for credits on the books of such banks, used or applied to the purchase of goods and services. Particularly is this true in those cases where the purchasing power so used takes a form which is available as "reserve" against other credits to be granted by the banks. Thus, for example, if the banks which purchased bonds in the illustration already given at once rediscount their own notes secured or protected by these bonds, at Federal Reserve banks, they thereby obtain a credit on the books of Federal Reserve banks which will sustain, theoretically at least, several times its own amount in the form of credits on the books of the banks which have been granted the rediscount. This means that the credit so granted may serve several times as a medium of purchasing power employed in gaining control of goods and services. In so far as paper secured by government bonds has been discounted on a semi-permanent or renewal basis, the Federal Reserve System may thus be regarded as serving as a means of "inflation." The same would be true of any banking system

which was placed in a position requiring the conversion of long-term obligations into immediate means of purchase.

Out of the same discussion has grown up a much clearer understanding, also, of the relation between loans and taxation. At the opening of the war there was a distinct tendency in many quarters to regard the effect of loans and taxation as distinctly different from one another. It is now apparently quite generally admitted that this is a distinction without a difference, and that the whole question between loans and taxation depends upon whether the funds furnished in either case are likely to be the result of saving or of bank borrowing. Taxes paid by a contributor from the proceeds of loans obtained by him would be an agency in "inflation," whereas a government bond sold to an investor who purchased it from funds saved out of his current income would not be. This modified view of the case largely does away with the cruder theories expressed early in the war and based upon the view that taxation practically always tended to keep down prices while loans in a similar way tended to advance them. Experience is showing that there is no basis for any such view, and the prevailing view of the general problem is being modified accordingly, as just indicated.